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BEFORE THE ARIZONA CORPORATION COMMISSION

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KRISTIN K. MAYES, Chairman
GARY PIERCE
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IN THE MATTER OF THE APPLICATION
OF CORONADO UTILITIES, INC. FOR A
CERTIFICATE OF CONVENIENCE AND
NECESSITY TO PROVIDE WASTEWATER
SERVICE IN PINAL COUNTY, ARIZONA.

DOCKET NO. SW-04305A-05-0086

IN THE MATTER OF THE APPLICATION
OF CORONADO UTILITIES, INC. FOR
AUTHORITY TO ISSUE SHORT AND
LONG-TERM DEBT IN CONNECTION
WITH THE ACQUISITION OF THE
WASTEWATER UTILITY PLANT OF BHP
COPPER, INC. AND CONSTRUCTING
IMPROVEMENTS THERETO.

DOCKET NO. SW-04305A-05-0087

STAFF'S RESPONSE TO COMMENTS OF
CORONADO AND BHP

Staff hereby files its response to Coronado Utilities Inc's ("Coronado") comments filed on December 18, 2009 and January 16, 2009 and to the public comments filed by BHP Copper ("BHP") on December 19, 2009.

1. Does the Commission have jurisdiction to make a determination that BHP Copper either is, or was, a public service corporation?

Coronado states that this issue is not the Company's issue and that it is an issue between the Commission and a third-party over the extent of the Commission's lawful authority.¹ Coronado also states that it does not wish to incur the costs of research and analysis to develop a proper legal opinion on the matter and that the issue should not impact its rights.² BHP states in its December 19, 2008 public comment that it is not presently a public service corporation, and thus the Commission cannot exercise jurisdiction over BHP, even to determine its past status.³

As Staff stated in its initial comments, it is likely that BHP was acting as a de facto public service corporation when providing sewer service to the residents of San Manuel. However, to-date,

¹ Coronado Response at 1.

² Id. at p. 2.

³ BHP Response at 1.

1 BHP has not participated as a formal party in any of the proceedings before the Commission
2 involving the provision of sewer service to San Manuel residents. BHP was not a formal party to the
3 proceeding granting Coronado a Certificate of Convenience and Necessity ("CC&N") to assume
4 ownership and operate the sewer system in San Manuel formally owned by BHP.

5 While the Commission could reconsider its original decision pursuant to A.R.S. Section 40-
6 252 and change the terms and conditions of transfer and potentially address BHP's status as a public
7 service corporation, such efforts are likely to result in protracted litigation which in Staff's opinion
8 would not be in the best interests of the residents of San Manuel. It is not Staff's desire to engage in a
9 lengthy legal dispute over whether BHP was a public service corporation at the time of the transfer of
10 its assets to Coronado and whether the Commission could fine BHP for not maintaining the system in
11 compliance with state and federal laws.

12 Rather, Staff believes that BHP, Coronado and the Commission need to work together to find
13 a way to address the problems facing the San Manuel residents with respect to their sewer system.
14 As a preferred stock holder and long-time supporter of the San Manuel community, BHP has an
15 interest and stake in the outcome of this matter. It may be argued that BHP never fully relinquished
16 the utility itself. BHP merely sold a majority of its interest in the utility.

17 Any financial resources should be directed to resolving the community's problem rather than
18 engaging in protracted litigation.

19 **2. What actions does the Commission need to take to make such a determination?**
20 **For instance, does the Commission need to make BHP Copper a party to the**
21 **proceeding? And if yes, how should the Commission proceed?**

22 In its Comments, Coronado states again that this is not its issue.⁴ It further states that if the
23 Commission does proceed to adjudicate whether BHP is a public service corporation, the
24 Commission should not require the Company to participate in such proceedings.⁵ BHP states that
25 unless BHP voluntarily submits to the jurisdiction of the Commission, the Commission would need
26 to seek a determination from the courts as to whether BHP is or was a public service corporation.⁶

27 ⁴ Coronado Comments at p. 2.

28 ⁵ Id.

⁶ December 19, 2008 public comments of BHP at 2.

1 BHP further states that even if the Commission could prove that BHP was a public service
2 corporation, no provision of law allows the Commission to exercise authority over former public
3 service corporations.⁷ BHP also states that given the circumstances, the Commission would be
4 estopped from arguing that BHP is or was a public service corporation.⁸

5 The Staff continues to believe that should the Commission proceed to adjudicate whether
6 BHP was a public service corporation, it would need to make BHP a party to such proceeding. Since
7 it is unlikely given BHP's filings that it would voluntarily participate in such a proceeding, it is likely
8 that the Commission would have to seek a judicial determination of BHP's status, and of its rights
9 and obligations related thereto during the relevant time periods. As already stated, Staff believes that
10 any financial resources are best directed toward resolving the issues raised in this case, rather than
11 used in litigation.

12 **3. How could or would a determination that BHP Copper is, or was, a public service**
13 **corporation affect Coronado's current rates?**

14 Coronado states that it does not believe that such a determination could impact its current
15 rates.⁹ BHP did not directly address this issue.

16 Although the Commission was never asked to approve an application authorizing an asset
17 transfer, the assets of BHP were certainly transferred from BHP to Coronado, even though Coronado
18 only intended to use some of them for an interim period of time until the newly-financed wastewater
19 treatment facility was completed. In fact, to this day, a portion of the BHP assets remain used and
20 useful in the provision of service. In short, the assets did transfer from BHP to Coronado and the
21 Commission could re-examine the circumstances under which that transfer was allowed to happen.

22 A determination that BHP was a public service corporation at the time of the transfer and
23 reconsideration pursuant to A.R.S. Section 40-252 of the terms and conditions of the transfer could
24 potentially impact the rates paid by San Manuel residents. In addition, a finding that BHP did not
25 maintain the system in compliance with state laws could result in the imposition of a fine or in lieu of
26

27 ⁷ Id.

⁸ Id.

28 ⁹ Coronado's Comments at 2.

1 a fine a contribution toward the system which could also potentially reduce the rates San Manuel
2 residents pay.

3 **4. Can the Commission require Coronado to modify its capital structure to mitigate**
4 **rates? If not, why not? If yes, what actions or determinations are required to**
5 **make such modification?**

6 Coronado states that if the action by the Commission results in rates that do not allow the
7 Company to recover its reasonable and prudent operating expenses and earn a fair rate of return on its
8 property, the Company does not believe it would be proper.¹⁰ The Company also states that
9 piecemeal ratemaking should be avoided.¹¹ BHP did not address this issue in its public comments.

10 The Commission could require Coronado to modify its capital structure to mitigate rates if the
11 evidence in the record supported the adoption of the new capital structure and the Company was
12 allowed to recover its reasonable and prudently incurred operating expenses and earn a fair return on
13 its investment.

14 The Commission would likely want to hold an evidentiary hearing so that evidence could be
15 taken on the propriety of a new capital structure for the Company. In its initial comments, the
16 Company states that practically speaking, additional debt or equity financing is not realistic at this
17 time.¹²

18 **5. How would a different capital structure be likely to affect rates?**

19 The Company's response indicates that it believes that approval of a new capital structure at
20 this time is not in the public interest. With respect to increased equity financing, the Company states
21 that it is not earning a return on its investment and that this makes capital attraction unlikely.¹³ It also
22 states that there are certain restrictions associated with the Company's bonds, and the bondholders are
23 unlikely to agree to any action that increases their risk, not to mention the financing costs could be
24 much higher today.¹⁴

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26 ¹⁰ Id. at 2-3.

27 ¹¹ Id. at 3.

28 ¹² Id. at 3.

¹³ Company Comments at 3.

¹⁴ Id.

1 Staff agrees with the Company's assessment that increasing the debt component could have
2 the effect of reducing the cost of capital and result in lower rates. Increasing the equity component
3 would likely result in increased rates, however.¹⁵

4 The Company's capital structure already is more than 70% debt. Thus, the Commission must
5 be mindful that increasing the amount of debt and making the Company more leveraged than it is
6 already, may increase the Company's overall financial risk.

7 **6. Given the Company's current capital structure, would it be in the public interest**
8 **to utilize a different capital structure? If so, how could the Company achieve a**
9 **different capital structure?**

10 The only way to determine whether another capital structure would be in the public interest,
11 would be to take evidence on the issue in the context of a hearing. As the Company notes in its
12 initial comments, requiring additional debt would place the Company's financial risk at an ever
13 higher level than it already faces with a 70% debt capital structure. Further, given the current market
14 conditions, the Company states that it no longer has access to the same low-cost capital it was able to
15 initially obtain.¹⁶

16 If the Company could find access to low-cost capital, it may be able to increase the debt
17 component of its capital structure, which may result in lower rates. The initial capital structure
18 proposed by the Company was 87% debt and 13% equity. Whether or not the original capital
19 structure proposed by the company is in the public interest, after one weighs the impact upon
20 ratepayers with the increased financial risk it would create for the Company, would have to be
21 examined within the context of a hearing.

22 The Company notes in its reply comments, however, that even assuming debt could be
23 obtained to pay down equity, returning to the capital structure originally proposed by Coronado,
24 would impact rates by no more than a few dollars a month.¹⁷ While it may be the case that finding an
25 alternative capital structure would be difficult, it is not a foregone conclusion that such an effort
26 would be fruitless. Staff therefore continues to believe that the Commission should explore this issue
27 and other potential solutions.

28 ¹⁵ Id.

¹⁶ Company's Comments at 4.

¹⁷ Coronado Reply Comments at 3.

1 **7. Will any change in rates require a finding of fair value? If not, why not? If yes,**
2 **what type of evidence or proceeding is required to make such finding?**

3 Coronado states that there are serious dangers inherent in piecemeal ratemaking.¹⁸ Coronado
4 also states that there are exceptions for interim rate relief-when the Commission delays approving
5 new rates or in the event of an emergency. Coronado states that it is facing neither of these two
6 scenarios.¹⁹

7 Staff's position is that a change in rates that is not diminimis would require a finding of fair
8 value. The circumstances of the current case do not meet the criteria for interim rates, such that a fair
9 value finding would not be necessary.

10 Ideally, the Commission may be able to use the fair value finding from Decision 68608
11 (March 23, 2006) upon which to base any rate changes until the Company's upcoming rate case is
12 filed in July, 2009. Alternatively, the Commission could make a separate fair value finding based
13 upon information supplied by the Company. The preferred approach would be to determine fair
14 value (along with any concomitant rate changes) in the Company's upcoming rate case; and to make
15 any necessary rate adjustments at that time.

16 **8. Are there any other ways to achieve the Commission's stated goals of mitigating**
17 **rates?**

18 The realities of this situation according to the Company are set forth in the Company's
19 response:

20 "Coronado respectfully suggests that the goal of mitigating its rates is not
21 realistic. The Company is operating a brand new wastewater treatment facility
22 serving a very small and isolated customer base. There is no realistic
23 possibility of growth in the CCN in the near future. Meanwhile, the Company
24 is operating on expense levels that are 5 or more years out of date. It also has
25 an extraordinary level of non-payment and little practical means of collecting
26 these past due amounts. It may not be politically palatable, but this Company
27 is likely going to require rate increases, not decreases, in order to continue
28 operating with an adequate opportunity to earn a fair return on its rate base."²⁰

18 Coronado Comments at 4.

19 Id.

20 Company Comments at 4-5.


1 With respect to other rate mitigation measures, at a minimum, Staff suggests that the
2 Commission require the Company to file tariffs for low-income and for payment plans that allow for
3 bill payment over an extended period of time for those who qualify.

4 **9. Any other issues the parties believe need to be addressed.**

5 Staff is concerned with the tenor of both the Company's comments and BHP's comments.
6 Both appear to be doing little more than posturing for litigation. What is needed is some creative
7 thinking on everyone's part to address the issues these residents face.

8 Staff agrees that the rate application Coronado has been ordered to file may provide an
9 appropriate venue for the exploration of a potential solution. However, Staff does not believe that
10 this would be the only venue with such potential. If the Hearing Division believes that the public
11 interest might be better served if the problem was addressed more contemporaneously, then the
12 Hearing Division could order such discussions to take place.

13 RESPECTFULLY SUBMITTED this 23rd day of January, 2009.

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